

September/October 2001

CALIFORNIA FRANCHISE TAX BOARD

New law puts corporation merger process on fast track

Merging corporations will face fewer delays in California as a result of recently enacted legislation.

Senate Bill 324, enacted July 9, amends Section 1107.5 of the Corporations Code to allow the Secretary of State to file an *agreement of merger* of two or more corporations without receipt of a *certificate of satisfaction* from us.

Removing this previously required step shaves up to 60 days off the merger finalization process for domestic corporations or foreign (non-California-incorporated) corporations qualified to do business in this state.

Prior to SB 324, the only mergers the Secretary of State could file without receiving a *certificate of satisfaction* from us involved domestic disappearing corporations that filed *articles of incorporation* with the Secretary of State less than 60 days from the date of filing the *agreement of merger*.

With the new law, the Secretary of State can file any merger without obtaining a *certificate of satisfaction* from us, provided the surviving corporation is a domestic corporation or a foreign (non-California-incorporated) corporation qualified to do business in this state.

The surviving corporation is responsible for filing all returns for the disappearing corporation and paying any tax liability owed by the disappearing corporation.

Prior to the passage of SB 324, to finalize a merger, among other things, the surviving corporation was required to submit a copy of the *agreement of merger* to the Secretary of State, and in turn, the Secretary of State was required to file the agreement. Once the *agreement of merger* was filed, the parties to the merger were immediately treated as one corporation and the merger was considered effective on the date the agreement was originally

Continued on page 3

Electronic services, Internet use rise during 2001 filing season

The filing season figures are in; and, as expected, taxpayers' appetite for electronic services continues to increase.

This filing season, the number of taxpayers who filed their personal income tax returns electronically and the number of taxpayers who chose a

paperless payment option reached all-time highs.

Here's more data from this year's filing season:

Continued on page 6

Inside...

Taxpayer Advocate explains tax consequences of rolling blackouts
Page 3

Tax Policy Conference comes to Los Angeles in November
Page 3

Use e-file to take the sting out of head of household questionnaires
Page 6

Direct Filing Portal available to practitioners in 2002
Page 7

Tax News

Volume 00-5 September/October 2001

TAX NEWS is a bimonthly publication of the Communications Services Bureau, California Franchise Tax Board. Its primary objective is to provide information to income tax practitioners about state income tax laws, regulations, policies and procedures.

Members of the Board:

Kathleen Connell, Chair
State Controller
Claude Parrish
Chair, State Board of Equalization
B. Timothy Gage
Director, Department of Finance

Executive Officer:
Gerald H. Goldberg

Editor:
Marvin Meek

To update or correct your address or to subscribe to TAX NEWS (send \$12 for a one-year subscription), write:

TAX NEWS
PO Box 2708
Rancho Cordova CA 95741-2708
or call: 916.845.7070

To view TAX NEWS on the Internet or to request an electronic mail subscription, contact FTB on our website:
www.ftb.ca.gov

For information about a client's account, contact:

Tax Practitioner Support Unit
phone: 916.845.7057
fax: 916.845.6377

For recorded answers to questions on California taxes, to order forms, or to check on a refund, call:

800.338.0505
From outside US. 916.845.6600

To send a facsimile about a client's account, transmit to:
Electronic Correspondence
916.845.6377

Information Center
800.852.5711
From outside US 916.845.6500

Hearing Impaired
TDD 800.822.6268

FTB on the Internet
www.ftb.ca.gov

Printed on recycled paper.

Is filing returns getting easier?

Our strategic goals for 2001-2005 include promoting fair and effective tax administration to taxpayers.

In adopting this goal, we continuously strive to make it easier for taxpayers and other stakeholders to file their California income tax return.

We've implemented several new programs aimed at making it easier for you and your customers to interact with us; whether you are filing returns, making payments, or seeking information about state taxes.

But are we making any progress? To find out, we asked 5,000 of our customers to tell us what they think about us.

On July 25 we mailed 5,000 customer service surveys to a random selection of taxpayers who filed Form 540, Form 540A, or Form 540 2EZ for the 2000 tax year.

The survey was designed by an independent consultant from the California State University-Sacramento to measure our customers' satisfaction. The consultant will help administer the survey, receive and tabulate the returned information, and report the final results. We will publish the results once they are available.

This is a follow-up to a customer service survey we conducted in 1998. Back then, we also sent surveys to 5,000 randomly selected California taxpayers who filed Form 540 and 540A for the 1997 tax year.

FTB announces Year 2000 tax form corrections

Please note the following corrections to tax year 2000 California tax forms and instructions. Should you have any questions about these clarifications, contact our Tax Forms Development and Distribution Section at 916. 845.3442.

Instructions for Schedule D-1, Sales of Business Property, Page 2, Column 1, and Line 18 –Corporations, and Column 3, Line 38 – Corporations. These lines were revised to read as follows:

Form 100 or 100W line 8, other additions; or line 15, other deductions...

The error is in Package X (paper and CD-ROM release 00.1 and release 00.2). The Internet version is correct.

Publication 1032, Tax Information for Military Personnel, Page 4, Column 2, Section I, Child and Dependent Care Expenses Credit, second sentence. This sentence has been revised to read as follows:

To be eligible to claim this credit your California adjusted gross income must be less than \$100,000.

The error is in Package X (paper and CD-ROM release 00.1 and release 00.2). The Internet version is correct.

Tax Practitioner Services

Tax Practitioner Services
Hotline telephone numbers.

Tax Practitioner Hotline
Telephone 916. 845.7057
Fax 916. 845.6377

Personal Income Tax Collection
Fax 916. 845.0494

Business Entities Collection
Fax 916. 845.0145

FTB e-file Help Desk
Telephone 916. 845.0353

California Tax Policy Conference to be held in Los Angeles this year

The 17th annual California Tax Policy Conference will be in Los Angeles at the Beverly Hilton Hotel on November 7-9. This is first year the conference will be held in Los Angeles.

The workshops will showcase lively discussions on tax incentives and benefits available in California and other states; the ethical framework and rules under which state tax matters are processed; critical issues in current tax policy and practice; currently available remedies in tax matters before various administrative forums and in tax litigation matters; and the present Section 25137 process.

In addition, four state tax commissioners will discuss tax policy and administrative issues that are currently impacting their states and regions.

Some of the speakers and participants who will be attending include:

- State Controller Kathleen Connell;

- State Board of Equalization Chair Claude Parrish
- James Speed, Executive Director, State Board of Equalization;
- Gillian Spooner, director of tax policy, KPMG LLP, Washington D.C.;
- Gerald H. Goldberg, Executive Officer, California Franchise Tax Board
- Tax Commissioners Elizabeth Harchenko (Oregon), Arthur Roth (New York), and June Summers Haas (Michigan);
- Richard Pomp, law professor at the University of Connecticut
- Paul Frankel, partner with Morrison & Foerster LLP in New York; and
- Other prominent tax attorneys and law professors.

For more information, call us at 916.845.7998 or go to our conference web page at www.ftb.ca.gov/education/ctpc.

Corporation mergers on fast track

Continued from page 1

submitted to the Secretary of State by the surviving corporation. However, before the Secretary of State could file the merger agreement and finalize the merger, they had to request and receive a *certificate of satisfaction* from us.

Here's why: According to California law, upon the merger of two or more corporations, the separate existence of the disappearing corporations ceases, and the surviving corporation assumes all of the debts and liabilities of each disappearing corporation in the same manner as if the surviving corporation

had incurred them directly. This includes the obligation of the disappearing corporations to prepare and file tax and information returns as well as the obligation to pay any tax liability due.

By our issuing a *certificate of satisfaction* we certified to the Secretary of State that we are satisfied, from the available evidence, that all taxes imposed on the disappearing corporation were paid or were secured by bond, deposit, or otherwise. Without the *certification of satisfaction* requirement, mergers of qualifying corporations will be completed faster.

Ask the Advocate



Debbie Newcomb
Taxpayer
Advocate

Q: What are the general tax requirements for reporting losses attributable to rolling blackouts?

A: In general, losses attributable to rolling blackouts would have the same tax requirements as any other loss experienced during the year. Taxpayers are allowed to deduct losses incurred in trade or business, losses incurred in transactions entered into for profit, as well as losses on nonbusiness property arising from casualty or theft.

To qualify as a *casualty loss* (business or nonbusiness) the loss must be *sudden, unexpected* or *unusual*, and it cannot be compensated by insurance.

If it's a business casualty, i.e. if business assets were damaged or lost during a blackout, 100 percent of the loss is deductible.

If the loss resulting from a blackout is a *nonbusiness casualty*, the deductible amount of the loss is the lesser of the adjusted basis of the property or the decrease in fair market value, and the amount must exceed \$100 and 10 percent of the taxpayer's adjusted gross income.

To calculate the decrease in fair market value, compare the

Continued on page 4

New law allows for information sharing among agencies

Effective June 30, 2001, California law requires us to provide address information for individuals with outstanding arrest warrants to the Department of Justice, courts, and California law enforcement agencies.

Senate Bill 1310 amended sections 19820 and 19823 and added Section 19550 to the Revenue and Taxation Code.

The bill also added Penal Code 817.5, which extends these requirements to all state and local government agencies.

Ask the Advocate: Rolling blackouts

Continued from page 3

property's fair market value immediately prior to the blackout and its fair market value immediately after the blackout.

Important: *Do not use the amount of the property's perceived value lost during operation, or a decline in business reputation. For example, loss of sales due to a blackout is an operating consequence and should appear in the computation of the taxpayer's income or loss.*

For example: If a truck is damaged because traffic lights are inoperable during a blackout, the decrease in the fair market value of the truck *may* qualify as a nonbusiness casualty loss as long as the decrease in fair market value wasn't compensated by the taxpayer's insurance.

Businesses could incur losses in revenue or production if a blackout occurs during operating hours. These losses are *normal operating expenses*. If inventory is damaged, spoiled, or lost, the taxpayer should adjust the costs of goods sold. It should not be reported as a business casualty or theft loss.

Q: What type of expenses/losses may be attributable to rolling blackouts?

A: The types of losses or extra expenses that could occur during a blackout would be similar to any type of loss resulting from an *unexpected* outage. The difference this year in California will be the *frequency* of this typically *unusual* situation. It doesn't change the type of losses or expenses incurred, just the number of losses (frequency) occurring and the amount of expenses.

Impact on individual taxpayers

For most individual taxpayers, the losses should be minimal to moderate and limited to those that normally occur when there is an interruption in power (assuming the outages average 60 -90 minutes in

duration), i.e. food spoilage and disruptions in automated home monitoring devices such as automatic irrigation, swimming pool filtration and home security systems.

There's the potential for damage to household appliances, e.g., computers and televisions, in the event there is a power surge once service is restored. And on the roads, there's also the potential for an increased risk of motor vehicle accidents if traffic control systems are not functioning.

And while not necessarily a casualty loss, there could be significant impacts to individuals with health conditions that require electrically operated home health devices or must maintain constant household temperatures.

Impact on businesses

For businesses, the losses from rolling blackouts can be costlier than those suffered by individual taxpayers. For most businesses, the loss of income or property resulting from a rolling blackout (power interruption) is not covered by insurance unless the outage goes beyond 12 - 48 hours. Consequently, losses such as spoilage of product, lost income, production downtime, cost of idle employees, etc. will not be reimbursed by insurance. Instead, the cost will generally be borne by the business owner. Some of the losses attributable to rolling blackouts that businesses might incur include but are not limited to:

- Loss of product.
- Damage to machinery and equipment as a result of a sudden loss of power.
- Inopportune failure of safety equipment and other devices dependent on external power.
- Lost (unrecorded) sales resulting from disruptions in the automated recording of business transactions.
- Increases in damaged or spoiled products in businesses dependant on food preparation, i.e. restaurants, bakeries, caterers, etc.

Continued on page 5

Ask the Advocate: Tax consequences of rolling blackouts

Continued from page 4

- In agricultural businesses, increases in goods lost, livestock injured or dead, etc. as a result of power interruptions to systems providing cooling, heating, water, etc.
- Decreases in productivity or reduced pay for workers.
- Injuries to customers or employees caused by inadequate lighting.

Q: Generally, when would such expenses/losses be allowed (tax year incurred)?

A: Expenses and losses are allowed in the taxable year in which they are incurred. Theft losses are allowed in the taxable year they are discovered. Personal expenses are not deductible. So nonbusiness expenses or losses must meet the requirements of a casualty or theft loss to be deductible.

Q: Are such expenses/losses deductible for federal purposes?

A: Generally, yes. California incorporates the federal provisions for deducting business expenses and losses (Internal Revenue Code 162, 165/ California Personal Income Tax Law 17201, 24347, and 24343) California follows the same rules for reporting spoilage or loss of inventory, casualties and thefts.

Q: How are such expenses/losses reported on the tax return?

A: Expenses are reported as any other ordinary and necessary business expense. Here are some general guidelines:

Your C Corporation clients would report expenses on a *Schedule F, Computation*

of Income, filed along with a corporate tax return. They would report inventory losses in the *Cost of Goods Sold* section (Schedule V). They would report any casualty or theft losses on *IRS Form 4684, Casualties and Thefts* and include it with the California return.

Your sole proprietor clients would report expenses on a *Schedule C*, filed with a personal tax return. They would report any casualty or theft losses on *IRS Form 4684, Casualties and Thefts* and include it with the California return.

Q: Can any losses be carried over or reported in years other than the year the loss was incurred?

A: Losses and expenses are reported in the year they are incurred. If they result

in a net operating loss, the net operating loss can generally be carried over for five years.

Q: What type of documentation would you require?

A: The blackouts themselves will not create different substantiation requirements. Businesses are expected to keep documentation of items purchased, sold, lost, or disposed of while operating a business. For personal casualty losses, taxpayers should be able to substantiate that they owned the property, the adjusted basis of the property, any repair costs, or decrease in fair market value.

For more information refer to IRS Pubs 535, *Business Expenses*, 547, *Casualties*, 552, *Record Keeping*, and 536 *NOL*.

More situations, consequences of blackouts

Here are a few hypothetical blackout situations and the state tax consequence for each.

Situation 1: Poultry and egg farmers use fans and water to cool the barns housing their birds. During a blackout, they lose some of their birds due to overheating.

Tax consequence: Loss of inventory, reduction in profit. Requires adjustment in cost of goods sold on tax return.

Situation 2: Restaurant's perishable food items spoil during a blackout.

Tax consequence: Loss of inventory. Requires an adjustment in cost of goods sold on tax return.

Situation 3: Caterer cannot cater an event because of blackout. (Food preparation halted resulting in spoilage) Caterer loses client and doesn't get paid remaining balance.

Tax consequence: Claims as a business expense on tax return.

Situation 4: Retail store cannot conduct business during the blackout and loses potential sales.

Tax consequence: Reports a lower sales volume on tax return.

You can still e-file during extension period



Now that you've filed your clients' federal return (the federal extension

deadline was August 15), you can still e-file their state tax returns during the extension period through October 15.

Last year, the number of e-file returns submitted during the extension period increased by 116 percent (175,526 in 2000 compared to 81,298 in 1999). Tax practitioners filed 67 percent of the total

number of e-file returns received during the extension period.

October 15 is right around the corner! If you have any questions about how to e-file during the extension period, point your browser at our website at www.ftb.ca.gov or contact our e-file Help desk at 916.845.0353.

Form FTB 1540e makes filing more convenient for head of household taxpayers who e-file

Taxpayers who e-file their questionnaire less likely to receive follow-up letter

You can give your head of household customers more for their money by letting them complete their head of

household questionnaire electronically the same time they e-file their return.

Many tax preparation software packages contain form FTB 1540e, *Head of Household Questionnaire*. When your head of household customers e-file their return and complete the head of household questionnaire electronically, their chance of receiving an audit letter to verify their filing status is minimized.

Last year, more than 237,000 e-file customers completed the questionnaire. Of those, less than 1,000 received an audit letter. As a result of more taxpayers using e-file and Form FTB 1540e to file their head of household questionnaire, we issued 45,000 fewer audit letters this year. To find out if your software offers Form FTB 1540e, ask your software developer.

Electronic services, Internet use rise during 2001

Tax practitioners account for nearly two million e-file returns this year

Continued from page 1

- This year, one out of every five personal income tax returns came to us electronically.
- Of the 13.2 million personal income tax returns we received so far this year (through July 3), 2.7 million were filed electronically.
- Tax practitioners accounted for nearly two million e-file returns this year, up from 1.6 million returns a year ago.
- Our Direct Filing Portal accounted for more than 17,000 returns in its inaugural season.
- This year nearly 82,000 taxpayers paid their taxes using e-pay—43 percent more than last year.
- Credit card payment transactions are up 27 percent over last year.
- Nearly 17 million visitors came to our website this filing season, a 62 percent increase over last year.
- So far this year, more than five million calls came into our automated toll-free telephone service, 30 percent more than last year.

Direct Filing Portal available to practitioners in 2002

Many of you have told us you want to use our Direct Filing Portal to file clients' returns. Next year you will be able to use the portal, provided your commercial tax preparation software and electronic filing software are compatible with our portal.

The Direct Filing Portal, which debuted in January, allows taxpayers to send their return to us electronically, via the Internet. No modems. No third party transmitters. If you are interested in using the portal in 2002, first contact

your software provider or your e-file transmitter. If you would like to learn more about how portal filing could work for you, call Julie Moreno at 916.845.3460 or Sean McDaniel at 916.845.6180.

E-Government blueprint helps us improve customer service

Increased security, greater access for tax practitioners top list of goals for 2002

Getting you (if you are your client's authorized representative) the access you need to resolve your client's account via the Internet heads the list of initiatives we've tackled since publishing our *E-Government Blueprint* a year ago.

Our goal is to implement safe and secure means for getting you access to your clients' balance due and payment information via our website, as well as offering ways for you to use e-Pay to pay your clients' tax bills electronically.

We've already made considerable progress in implementing programs that give taxpayers greater access through the Internet.

For example, if any of your clients receive a nonfiler letter from us, they now can log on to our webpage at www.ftb.ca.gov/INC, enter a unique 15-digit notice number and access a variety of options for resolving their account.

The program is called the Integrated Nonfiler Compliance Program and through it taxpayers can get information that will assist them in filing tax returns and making payments using one of our various payment options.

They can also download tax forms, correct a misreported social security number, or, send us an email with their questions.

And don't forget our full service website, which gives you and your clients access to a full range of services through one convenient homepage.

To see our *E-Government Blueprint*, set your browser to <http://www.ftb.ca.gov/other/index.html>. Send any comments or questions about our e-gov initiatives to denise.springer@ftb.ca.gov.

Legislative analyses available on Internet

On our website you can find pertinent information about the legislation we are tracking.

Go to www.ftb.ca.gov and click on the *Law and Legislation* button. There you will find a preview of proposed tax law changes and our analysis of how they might affect your clients if the legislation becomes law.

We also post proposed and final

regulations, legal notices and rulings, and links to the *Revenue and Taxation Code* and the *California Code of Regulations*.

You can find the full text of bills, resolutions, and constitutional amendments, and their status, history, votes, analyses, and veto messages at www.leginfo.ca.gov, the *Official California Legislation Information* website.

Tax News
PO BOX 2708
RANCHO CORDOVA CA 95741-2708
Address Service Requested

Presorted
First-Class Mail
US. Postage Paid
Sacramento, CA
Permit No. 312